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No. 91-1122

In The

Supreme Court of the United States

October Term, 1991

IN RE: PATRICK F. MESSING, AND NORA B. MESSING,

Debtors

ANN MOSTOLLER, TRUSTEE,

Petitioner,

vs.

PATRICK F. MESSING,

Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

Comes the Petitioner, Ann Mostoller, Trustee, and respectfully files this Reply Brief to Respondent's Brief in Opposition filed herein.

STATEMENT OF THE CASE

Petitioner wishes to point out that throughout the litigation in both the bankruptcy and district courts, Respondent took the position that his ERISA-qualified pension interest was included in his bankruptcy estate but was exempt. Only in the Sixth Circuit did Respondent argue that his pension interest was excluded from the estate, on the basis of the Sixth Circuit's intervening

decision in *Forbes v. Lucas (In re Lucas)*, 924 F.2d 597 (6th Cir.), *cert. denied*, 111 S. Ct. 2275 (1991). Even in his argument to the Sixth Circuit on the exemption issue, however, Respondent asserted:

> The debtor questions why Congress would have created a bankruptcy law pension plan exemption if pension plans in the first instance were excluded from property of the bankruptcy estate under 11 U.S.C. § 541(c)(2). It would appear that the drafters of 11 U.S.C. § 541 did not intend an exclusion of these benefits due to the fact that federal law allows an exemption under 11 U.S.C. § 522(d)(10)(E). The debtor asserts that an analysis of these statutes supports the better view that ERISA pension plan benefits should be included as property of the estate but exempt under 11 U.S.C. § 522(b)(2)(A).

Reply Brief of Appellants at 6, *Mostoller v. Messing*, No. 91-5087 (6th Cir. dated April 26, 1991).

It should also be noted that in this Court, Respondent asserts, "Congress intended to include ERISA-qualified pension benefits as property of the estate under 11 U.S.C. § 541(c)(2) and to permit exemption of such benefits under 11 U.S.C. § 522(b)." Cross-Petition for a Writ of Certiorari at 11.

SUMMARY OF ARGUMENT

On January 21, 1992, this Court granted certiorari on the statutory issue presented in this case: whether a bankruptcy debtor's interest in an ERISA-qualified pension plan is excluded from the bankruptcy estate pursuant to 11 U.S.C. § 541(c)(2). *Patterson v. Shumate*, 60 U.S.L.W. 3492 (U.S. Jan. 21, 1992) (No. 91-913), *granting cert. to* 943 F.2d 362 (4th Cir. 1991). The view represented by the Fourth Circuit's decision in *Shumate v. Patterson* and the Sixth Circuit's decision in the instant case incorporates an erroneous and unsound interpretation of the Bankruptcy Code. Petitioner respectfully prays that this Court grant the petition for certiorari, consider this case along with

Patterson v. Shumate, and reverse the judgment of the Sixth Circuit.

ARGUMENT

By granting certiorari in *Patterson v. Shumate*, 60 U.S.L.W. 3492 (U.S. Jan. 21, 1992) (No. 91-913), this Court has already recognized the importance of resolving the conflict among the Circuits on this fundamental issue of bankruptcy law. Petitioner would merely argue in reply to Respondent's Brief in Opposition that the view adopted by the Fourth Circuit in *Shumate v. Patterson* and by the Sixth Circuit here is erroneous as a matter of statutory interpretation and unsound as a matter of bankruptcy policy. The petition for a writ of certiorari should be granted so that this case can be heard and decided along with *Patterson*.[1]

The only new arguments raised by Respondent in his Brief in Opposition derive from the recent decisions of the Third and Tenth Circuits in *Velis v. Kardanis*, 949 F.2d 78 (3d Cir. 1991), and *Gladwell v. Harline (In re Harline)*, 950 F.2d 669 (10th Cir. 1991): (1) exclusion of ERISA-

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[1] The Petitioner was unable to include two cases adopting the minority view in the Petition because they were not published until after the filing of the Petition. *Velis v. Kardanis*, 949 F.2d 78 (3d Cir. 1991); *Gladwell v. Harline (In re Harline)*, 950 F.2d 669 (10th Cir. 1991). These two cases were decided on November 14 and December 5, 1991, respectively, but were not published until the January 29 and February 12, 1992, advance sheets, respectively, of the *Bankruptcy Reporter*. More significantly, the Petitioner regrets the Respondent's omission from his Brief in Opposition of any citation to this Court's grant of certiorari in *Patterson v. Shumate* on January 21, 1992. 60 U.S.L.W. 3492 (U.S. Jan. 21, 1992) (No. 91-913). This Court granted certiorari in *Patterson v. Shumate* on the instant issue subsequent to the filing of the Petition for Certiorari but prior to the Respondent's filing and serving of his Brief in Opposition, but the Respondent made no mention of the case.

qualified pension interests from the bankruptcy estate does not render 11 U.S.C. § 522(d)(10)(E) (the exemption section) superfluous; and (2) this Court's decisions on the preemptive effect of ERISA support exclusion of ERISA-qualified pension interests from the bankruptcy estate. *See* Respondent's Brief in Opposition at 8-10. Respondent notes the Third Circuit's attempt to harmonize sections 541(c)(2) and 522(d)(10)(E). The Third Circuit states, "Section 522 deals with *distributions* made from a pension plan and distributions which the debtor has a present and immediate right to receive." *Velis*, 949 F.2d at 81 (emphasis in original) (citing *Clark v. O'Neill (In re Clark)*, 711 F.2d 21 (3d Cir. 1983)); *accord Harline*, 950 F.2d at 675. But before property can be exempted from the estate, it must first be included in the estate. *See Payne v. Wood*, 775 F.2d 202, 204 (7th Cir. 1985), *cert. denied*, 465 U.S. 1085 (1986). Thus, under the Third Circuit's view in *Velis*, a debtor's ERISA-qualified pension interest becomes property of the bankruptcy estate (subject to the exemption provision of § 522(d)(10)(E)) only if distributions are actually being made to the debtor, or perhaps, if the debtor is presently entitled to receive distributions. *Velis*, 949 F.2d at 81.

But this "right to receive distributions" distinction is simply not a tenable way of distinguishing estate property from non-estate property. Whether a debtor has a present right to receive or is receiving distributions from the ERISA-qualified pension plan depends upon the debtor's own volition in the case of a self-settled, self-controlled ERISA plan, like the ones in *Patterson*, *Velis*, and *Harline*. The potential for abuse here is all too clear: if a debtor's non-distributed or non-distributable interest in an ERISA-qualified pension plan does not become property of the estate, then the debtor contemplating bankruptcy will simply take no distributions from the plan until the day after the bankruptcy case is closed. Even in

the case of an ERISA pension plan that is not self-controlled, the debtor may become entitled to receive distributions because of volitional or forced termination of employment. If the debtor's employment is terminated one day after the case is closed, those assets, which were being held all along for the debtor's benefit, will come into the debtor's hands free and clear of all creditors' claims, no matter how large the sum.

Recognizing the unworkable nature of the Third Circuit's rationale, Respondent attempts to narrow it to encompass only "distribution of funds under an ERISA *welfare* benefit plan," Brief in Opposition at 8 (emphasis in original), because welfare plan interests are clearly not excluded from the estate under § 541(c)(2) since they do not contain the anti-alienation provisions mandated by 29 U.S.C. § 1056(d)(1). Apart from the unwarranted attempt to put words in the mouth of the Third Circuit, Respondent's argument is simply not supported by the language of § 522(d)(10)(E), which provides that a debtor may exempt "[t]he debtor's *right* to receive . . . (E) a payment under a . . . *pension* . . . plan." (Emphasis added). The exemption provision, by its plain language, encompasses pension, not just welfare, interests, and also encompasses the *right* to receive payment, not just the payments themselves. Respondent's fallacious distinction clearly violates the "plain meaning" rule Respondent purports to espouse. None of the Circuits prior to the Third Circuit's decision in *Velis* made any such distinction, and the distinction is not supported by the legislative history. Respondent's argument demonstrates his awareness of the conceptual difficulties with the Third Circuit's approach. However, if the Third Circuit's rationale applies only to ERISA welfare plans, as Respondent suggests, it is irrelevant to ERISA pension plans, and the court's attempt to harmonize sections 541(c)(2) and 522(d)(10)(E) has failed.

Secondly, Respondent attempts to argue that the policy behind ERISA favors excluding a debtor's pension

interest from the estate, citing this Court's decisions in *Mackey v. Lanier Collection Agency & Service, Inc.*, 486 U.S. 825 (1988), and *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990). But the Court in *Mackey* simply held that ERISA preempts any *state* law referring to ERISA. 486 U.S. at 829-30. The instant case presents a conflict between two *federal* laws, ERISA and the Bankruptcy Code. Congress declared in ERISA that ERISA cannot serve to "modify, invalidate, impair, or supersede" the provisions of other federal laws. 29 U.S.C. § 1144(d) (1988). Yet that is precisely the effect of the view espoused by the Sixth Circuit here.

In *Guidry*, this Court held that a constructive trust could not be imposed upon a wrongdoer's ERISA-qualified pension interest as a remedy under the Labor-Management Reporting and Disclosure Act of 1959 (LMRDA), 73 Stat. 536, 29 U.S.C. § 501(c) (1982). The Court concluded that ERISA's anti-alienation provision is not subject to the remedial provisions of the LMRDA because giving precedence to ERISA would not modify, impair, or supersede the LMRDA. The Court's conclusion rested principally upon the absence of any clear congressional intent that the remedial provision of LMRDA take precedence over the non-alienation provision of ERISA. The Court found the LMRDA's provision for "a private right of action 'to recover damages or secure an accounting or other appropriate relief for the benefit of the labor organization,' " 493 U.S. at 374 (quoting 29 U.S.C. § 501(b) (1982)), too vague to overcome ERISA's anti-alienation requirement, particularly since the LMRDA has its own "savings clause," providing that " 'nothing in this Act shall take away any right or bar any remedy to which members of a labor organization are entitled under [any] other Federal law or law of any State,' " *id.* at 375 n.17 (quoting 29 U.S.C. § 523(a) (1982)).

The situation here differs markedly from that in *Guidry*. Here we have (1) an admittedly broad definition of property of the estate in § 541, (2) an exemption for

ERISA-qualified pension interests in § 522(d)(10)(E) that can only be effective if those interests become property of the estate, (3) consistent indications in the legislative history that the exception in § 541(c)(2) was intended to apply to spendthrift trusts under state law, and (4) no "savings clause" in the Bankruptcy Code to negate the effect of 29 U.S.C. § 1144(d). These factors indicate a congressional intent that § 541 of the Bankruptcy Code "override ERISA's prohibition on the alienation of pension benefits." *Guidry*, 493 U.S. at 375.

It is true that this Court has recognized a congressional policy of ensuring that individuals have sufficient assets with which to support themselves " 'upon retirement.' " *Connolly v. Pension Benefit Guaranty Corp.*, 475 U.S. 211, 214 (1986) (quoting *Pension Benefit Guaranty Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 720 (1984)). However, excluding a debtor's ERISA-qualified pension interest from the bankruptcy estate does nothing to ensure that those assets will be available for the debtor's retirement, especially in the case of a self-controlled plan, in which the debtor can essentially receive the benefits at will for any purpose, as in *Velis*, 949 F.2d at 80, where the debtor used the assets to purchase apartments.

The Tenth Circuit has expressed concern about "the incongruity inherent in the narrower interpretation which would result in ERISA's antialienation provisions trumping state law until bankruptcy, but withdrawing that protection upon bankruptcy unless state law would give it." *Harline*, 950 F.2d at 675. But this concern is misplaced. The plain language of ERISA, at 11 U.S.C. § 1144(d), provides that ERISA cannot "modify, invalidate, impair, or supersede" other federal law.[2] Furthermore, the

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[2] A debtor's creditors under "other federal law" may include the Internal Revenue Service. Like a debtor in bankruptcy, "[o]ften, a taxpayer's most significant asset is a right to pension benefits under an employee benefit plan governed by

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context of a single creditor's seeking access to the debtor's pension plan in state court is entirely different from the bankruptcy context, in which the entire statutory scheme is geared to a fair and orderly marshalling and distribution of a debtor's non-exempt property. It is one thing to ensure through ERISA that a single creditor cannot rush to judgment in state court and levy on the debtor's ERISA-qualified pension interest. It is a very different proposition to say that ERISA preempts the Bankruptcy Code so that a debtor's ERISA-qualified pension interest never becomes part of the estate no matter how large, no matter how self-controlled and self-manipulated, no matter how unnecessary it may be to the debtor's retirement. In the bankruptcy context, "ERISA protection" does in a sense "lapse." *Harline*, 950 F.2d at 673. In bankruptcy, the debtor gains certain protections

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the Employee Retirement Income Security Act and qualified for tax-exempt status under Section 401 of the Internal Revenue Code." Bergner, *IRS Using Authority To Seize Qualified Pension Plan Benefits*, 19 Pens. Rep. (BNA) 307 (1992). Accordingly, when justifiable, the IRS will levy on the benefits. *Id.* at 307. No reasoned rationale exists for distinguishing between the IRC and the Bankruptcy Code as "other federal law." The practice of the IRS in the context of bankruptcy is to take the position that "retirement plan benefits . . . constitute a portion of the debtor's estate." *Id.* at 310. "In PLR 8910035, IRS stated its agreement with the proposition that a retirement account in a plan that is a spendthrift trust is excluded from the debtor's estate under 11 USC Section 541(c)(2): 'funds in a qualified plan do not become the property of the debtor's estate because [of] the express exclusion accorded spendthrift trusts under 11 USC Section 541(c)(2).' " *Id.* at 310 n.12. One commentator has already noted the view adopted below as a mechanism available ~~for t~~those seeking to insulate pension benefits from collection by the IRS for payment of dischargeable taxes and from other creditors. *Id.* at 311. The potential for abuse will extend to debtors and taxpayers alike.

and benefits, such as the automatic stay and the discharge of debts, but in return, he or she must shoulder certain burdens, such as full disclosure of financial affairs. The creditors, likewise, sacrifice the fruits of unilateral diligence, and in return for a ratable distribution of non-exempt assets, become subject to the Bankruptcy Code's provision for recovery of preferences and fraudulent transfers. In this scheme for a fair and orderly rearrangement of financial burdens, it only makes sense for Congress to have intended that a debtor's ERISA-qualified pension interest be subject to the claims of creditors *if* it does not qualify as a spendthrift trust under state law and *if* it cannot be exempted under § 522(d)(10)(E) or any equivalent nonpreempted state exemption. Viewed in the bankruptcy context, it is the "all or nothing" approach of the Sixth, Fourth, Third, and Tenth Circuits that violates the intention of Congress. *See* Petition for Certiorari at 24-25.

Finally, Respondent emphasizes the Tenth Circuit's approval of the Fourth and Sixth Circuit's insistence on interpreting the phrase "applicable nonbankruptcy law" identically in each section of the Code in which it appears. Brief in Opposition at 6-7. This Court has recently rejected the interpretive approach urged by Respondent. In *Dewsnup v. Timm*, 112 S. Ct. 773 (1992), this Court refused to accept the argument that the phrase "allowed secured claim" must have the same meaning in two different subsections of § 506 of the Bankruptcy Code. *Id.* at 778. Instead, "given the ambiguity in the text," *id.* at 778, this Court looked at pre-Code law and the absence of any indication by Congress in the legislative history that it intended to change that law, *id.* at 778-79. Here, an equally strong case exists for not mechanically interpreting the phrase "applicable nonbankruptcy law" identically in all sections of the Code. First, the other uses of the phrase occur in different sections, not subsections of the same section, as in *Dewsnup*. Second, the word "applicable" renders the phrase

inherently ambiguous, making it necessary to look to the precise context in which it is used. *See* Petition for Certiorari at 15-16. Third, both the evidence of congressional intent contained in the legislative history and the logic and policy underlying the Bankruptcy Code support a reading of "applicable nonbankruptcy law" that would limit the § 541(c)(2) exception to ERISA-qualified interests that also meet state spendthrift trust requirements.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted, and this case should be considered along with *Patterson v. Shumate*, 60 U.S.L.W. 3492 (U.S. Jan. 21, 1992) (No. 91-913), *granting cert. to* 943 F.2d 362 (4th Cir. 1991).

March 11, 1992.

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